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August 21, 2001

Ms. Magalie Roman Salas
Office of the Secretary
Room TW-B204
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92.

Dear Ms. Salas,

Pursuant to Sections 1.415, 1.419, and 1.430 of the Commission's Rules, enclosed please find the Comments of the Ad Hoc Telecommunications Users Committee in the above-captioned matter.

Should you have any questions regarding this filing, please do not hesitate to contact me.

Sincerely,

James S. Blaszak

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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Comments

The Ad Hoc Telecommunications Users Committee (the Committee or Ad Hoc) hereby submits its Comments in response to the April 27, 2001 Notice of Proposed Rulemaking (NPRM) in the above-captioned proceeding.[1]

A. Summary

Ad Hoc supports the implementation of a well reasoned "unified regime for the flows of payments among telecommunications carriers that results from the interconnection of networks under current systems of regulation" and applauds the Commission for beginning "a fundamental examination of all currently regulated forms of intercarrier compensation."[2] Throughout its long history of participation in FCC ratemaking, and more specifically access charge, proceedings, Ad Hoc has always endorsed the principle of cost-based pricing because cost-based pricing of telecommunications service, when combined with a well-conceived and properly implemented universal service program, best serves the goals of economic efficiency and equity. The "bill-and-keep" proposal that is the heart of the NPRM is, however,

[1] *Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, FCC No. 01-132, released April 27, 2001, (the NPRM).

not consistent with cost-based pricing. Moreover, the “bill-and-keep” proposal seems to suffer from several faulty assumptions, without which the “bill-and keep” proposal makes little sense.

The second major problem raised by the NPRM is that the proposed rules do not offer a “unified regime” for the pricing of intercarrier connections – the rules proposed in the NPRM would unnecessarily use different time schedules for application of the new regime to different types of intercarrier payments. Changes to correct perceived problems with the pricing of ILEC-CLEC connections would probably be implemented in the relatively near future, but would likely be made to account for the known problem (above cost pricing) with LEC-IXC connections inside of five years.

B. The Proposed “Bill-and-Keep” Regime is Not Consistent with Cost-Based Intercarrier Compensation and is Based on Faulty Assumptions.

The proposed rule changes would replace one system of non-cost-based rates with another equally flawed system of non-cost-based intercarrier compensation that in all likelihood would be as unsustainable as the existing system. To the extent that a problem exists with the present system of intercarrier compensation for originating and terminating traffic (both ILEC-CLEC and LEC-IXC), the problem appears to be that intercarrier compensation rates are set in excess of the costs of originating and terminating the traffic. The solution proffered in the NPRM would essentially price traffic below cost (at $0.00). Purposefully pricing below cost is every bit as market

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2 NPRM at ¶ 1.

distorting as pricing above costs, and is certainly no more sustainable over the long term.[3] There is a cost associated with the termination of local calls, whether done by an ILEC or CLEC, and restructuring the pricing system to ignore those costs (such that the party that incurs them does not get paid) cannot be viewed as offering any improvement in economic efficiency. The only circumstance in which distortions arguably would not arise under the NPRM's "bill-and-keep" proposal would be one in which traffic flowing between carriers is in balance, or at least close to in balance.

Indeed, the very use of the term "bill-and-keep" in the NPRM is misplaced in the context of out-of-balance ILEC-CLEC traffic flows. "Bill-and-keep" is a longstanding method of intercarrier compensation used by interconnecting ILECs to exchange traffic between their non-overlapping service territories. It is premised upon the existence of a peer-to-peer relationship between the two carriers, reflecting an expectation that traffic flows will be roughly in balance. "Bill-and-keep" in this context is a method of in-kind reciprocal compensation in which each ILEC agrees to terminate traffic handed-off to it by the other ILEC without an explicit charge. Under this type of "bill-and-keep" arrangement, each participant in the arrangement is compensated, with the "compensation" being in the form of services rather than cash payments. The purpose of this "in-kind" vs. cash compensation arrangement is to avoid the transaction costs associated with metering and billing the actual traffic flows; the parties basically have concluded that the inequity of any minor traffic imbalance

[3] In a system in which originating and terminating call completion services are priced above cost, and carriers have the choice between being buyers or sellers, smart carriers will develop marketing and business plans that involve the selling of service at an above cost price. Conversely, if the prices are artificially priced below cost (or free!), smart carriers will choose the opposite of the buyer versus seller equation, and develop marketing and business plans that involve the buying of services at below cost prices.

would be more than offset by the two carriers' respective avoidance of these transaction costs.

No corresponding rationale exists with respect to the type of "bill-and-keep" ILEC-CLEC compensation arrangement being proposed in the NPRM. Indeed, the very foundation of the proposal differs from the traditional ILEC-ILEC peer-to-peer arrangement because it is not even being suggested as a method by which each carrier compensates the other; rather, the "bill-and-keep" proposal seems to be dependent on each carrier implementing rate structures that would use end user charges to compensate carriers for call termination functions. The NPRM advances the possibility that costs are now primarily capacity-sensitive rather than traffic-sensitive, suggesting that "[a]ccepting this latter assumption eliminates the need for traffic-sensitive interconnection charges."[4] Even if this assumption were true, which may not be the case, it would require adjustments to pricing practices at the retail level, adjustments that are not being proposed as noted above, by the NPRM and that if pursued would necessarily require massive restructuring of local rates in all states. But unless the Office of Plans and Policy scenario is captured at the retail price level, none of the claimed efficiency gains will be achieved. At a minimum, such an arrangement presupposes a fundamental change in the manner in which all LEC services (ILEC and CLEC) are priced to the end user retail customer, although the NPRM itself offers little practical advice as to how such a far-reaching change could be implemented universally (i.e., at both the intrastate and interstate levels).[5] Absent

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[4] NPRM at ¶ 28.

[5] For example, the NPRM at para. 28 notes Atkinson/Barnekov's observation "that the incremental costs of interconnection involve primarily capacity costs that should be recovered through flat charges. Accepting this latter assumption eliminates the need for traffic-sensitive

this fundamental revision in retail pricing, "bill-and-keep" as proposed in the NPRM amounts to "bill-and-pocket" where traffic is out-of-balance.

The rule changes proposed in the NPRM largely reflect theories detailed in papers released by the OPP, authored by Patrick DeGraba, and Jay Atkinson and Christopher Barnekov.[6] The papers' policy recommendations are premised upon the assumption that the benefits of calls are on average shared equally between the caller and the recipient – an assumption that is both unproven and likely untrue. This assumption is then used to support their theory that both parties – not just the call originator – should be viewed as the "cost causer" with respect to all calls. And since each party to the call is partly responsible for its cost, they conclude, it is reasonable that both parties be required to participate in the payment for those calls.

If, however, benefits in fact inure disproportionately to the calling party (except for 800-type services), then shifting half of the cost-recovery burden to the called party would be inefficient in that it would discourage recipients from answering their phones to the extent that the charge for doing so might be perceived as exceeding the benefits to be derived therefrom. Even if an accurate "allocation of benefits" could be accomplished, it is not at all apparent that the attribution of cost causation to track relative "benefits" is efficient or appropriate, particularly if the transaction cost arising from such a pricing regime is high, as it may well be. And even if this arrangement were implemented with respect to intercarrier compensation for ILEC-CLEC

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interconnection charges." If and to the extent that this "assumption" is accurate as a matter of fact, it would imply, in addition to the elimination of traffic-sensitive *interconnection* charges, the elimination of traffic-sensitive *retail end user charges* as well.

[6] Patrick DeGraba, *Bill and Keep at the Central Office as the Efficient Interconnection Regime*, (OPP Working Paper No. 33, December, 2000) and Jay Atkinson & Christopher Barnekov,

interconnections, it is unclear how – or if – this same principle would be applied in the case of calls completed wholly within the ILEC's network.

Whether both parties derive equal benefit is, however, not dispositive of the determination of the appropriate intercarrier pricing structure for the origination and termination of calls. Under the existing "sent-paid" approach to pricing local and toll calls, the calling party ordinarily pays for the entire call, end-to-end.[7] The originator of a call is thus treated as the "cost causer." The bill-and-keep approach would assign responsibility for cost-recovery on the basis of relative benefit, i.e., "value," to the calling and called parties. The Commission should avoid at all costs any movement toward the slippery slope of the kind of "value of service" based pricing that regulators of the telecommunications industry have worked so diligently to escape over the last two decades, but such value-based pricing is at the heart of the benefit analysis in the OPP papers.

The authors of both papers appear to subscribe to the view that any intercarrier compensation structure that results in a less than balanced flow of traffic between one carrier and another is somehow flawed and must be changed. As with their "equal benefit" theory, this premise is also unsupported by factual or economic evidence, is untested, and is most likely untrue. Prior to the introduction of competition in the local service market, when LECs provided service within non-geographically overlapping service areas, the expectation (and the reality) was that the transfer of traffic between

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A Competitively Neutral Approach to Network Interconnection, (OPP Working Paper No. 34, December, 2000).

[7] The exception is with respect to 800-type services, where the called party affirmatively elects to accept the charges that would otherwise be imposed upon the originator of the call. That notwithstanding, the same end-to-end payment by (in this case) the customer subscribing to the toll-free calling service still applies.

carriers would be relatively "in balance." The introduction of competitors into this segment changes the paradigm, and there is no longer any reason for the expectation that traffic will be in balance. The natural laws of competition dictate that if and to the extent that local service competitors can find particular classes of customers for whom they are able to originate or terminate calls (either because of greater efficiency than the ILECs, the use of less expensive technology than the ILECS, or above cost pricing by the ILEC) at a cost that is lower than what it would cost to have the ILEC originate or terminate those calls, then they should be successful in marketing those services to those particular classes of customers. At the present time, CLECs have found that situation to exist for customers that receive large volumes of incoming calls (terminating traffic), and have taken advantage of the real and natural opportunities for that segment.

Although the circumstances are somewhat different, the situation is not at all unlike changes that have been experienced in the methods used to originate and terminate calls in the access environment. At one point in the history of the long distance market (prior to the advent of the use of dedicated access connections for high volume origination and termination locations), the volumes of switched access originating and terminating minutes were relatively in balance. Over time, as the long distance market became more fully competitive, and long distance carriers and customers looked for ways to provision service more efficiently and at lower cost, the use of dedicated access connections for high-volume customers became a standard practice, and the balance between originating and terminating minutes shifted.[8] ILECs and some regulatory authorities expressed concern when substantial long distance service customers began to substitute the use of dedicated access facilities (which were themselves still provisioned in large part by the ILECs) for switched access facilities (which at the time were priced many multiples in excess of cost). However, the use of dedicated facilities in lieu of grossly over-priced switched access service represented exactly the kind of efficiency gain and price reductions that increased competition into the long distance market should have produced. And rather than discourage these arrangements, the Commission instead adopted policies (specifically, the shift toward cost-based pricing of switched access) that were expressly designed to encourage efficient choices as between switched and dedicated access.

C. If Bill-and-Keep is in the Public Interest, Interstate Access Charges, Not Just ILEC-CLEC Payment, Should be Revised Sooner Rather Than Later, to Reflect Bill-And-Keep.

Assuming, *arguendo*, that the premises of the DeGraba and Atkinson/Barnekov papers are correct – that both call originators and terminators benefit equally (on average) from calls, and on that basis that both parties should share equally in payment of the costs of that call – then this principle is just as "correct" for LEC-IXC calls (access charge rated calls) as it is for ILEC-CLEC calls (currently subject to reciprocal compensation). Moreover, to the extent that it is important that both the call

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8 Based upon data extrapolated from the FCC's Industry Analysis Division's *Long Distance Market Shares* report for the 4th quarter of 1998, calling using a single end of access increased from 22% of the total calling minutes in 1987 to 45% of total minutes in 1998. Table 1.1.

originator and call recipient be responsible for the costs of the call, any reforms to the underlying intercarrier compensation mechanism must be flowed through to end user pricing structures as well. The NPRM would not, however, apply the new bill and keep "regime" to access in the near term; nor would it require revamping of present end user retail pricing arrangements. Instead, the CALLS Plan would continue to control the pricing of most interstate access service.[9] Simply put, the NPRM proposes a broad and all encompassing theory for the repricing of phone service in the United States, but apparently would not apply it to interstate access service until another four or five years pass.[10] Put differently, the intercarrier compensation scheme would apply in the near term only to ILEC/CLEC payments. If, however, the bill-and-keep proposals (under different names) explained in the DeGraba and Atkinson/Barnekov papers have as much merit as suggested in the NPRM, bill-and-keep should also apply to interstate access service.[11] The Commission should not defer application of bill-and-keep to interstate access service. The public interest, not preservation of a "deal" between local exchange and long distance carriers, is the Commission's charge.

[9] *Access Charge Reform,* CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) ("*CALLS Order")*.

[10] NPRM at ¶ 97.

[11] The NPRM acknowledges that a bill and keep approach could have implications for toll free service (¶¶ 51 and 63). Toll free service is an important part of the economy and is important to vendor-customer relationships. Bill and keep could undermine toll free service as it is currently understood and used. Callers may encounter a charge, albeit at an unknown level at this time, to place a toll free call, a result that many toll free service subscribers would not favor. The answer, however, would not be to allow carriers providing terminating access to bill the toll free service subscriber directly because in this circumstance the market would fail to provide any check on the pricing of terminating access. This is the same market failure problem that the Commission addressed in *Access Charge Reform*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, FCC 01-146 (released April 27, 2001), that the victim would be the toll free service subscriber rather than the provider of toll free service.

D. Conclusion

There is no good justification for structuring different intercarrier compensation rules for ISP-bound local traffic, non-ISP-bound local traffic, and interstate access services, or for applying one set of compensation rules to intercarrier relationships and another – and entirely incompatible – set of rules to the retail pricing of all services. In all cases, the transmission of the calls (and underlying economic cost of providing the service) is identical. The economic signal that should be sent to the market, for all categories of intercarrier compensation, should be based upon the economic cost of originating or terminating those calls.

Respectfully submitted,

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August 21, 2001

Certificate of Service

I, Michaeleen Williams, hereby certify that true and correct copies of the preceding Comments of the Ad Hoc Telecommunications Users Committee was served this August 21, 2001 via the FCC's ECFS system upon the following:

Ms. Magalie Roman Salas
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Michaeleen Williams
Legal Assistant

August 21, 2001